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No. 170

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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION,

Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS,

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE CREDITORS COMMITTEE

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BRIEF OF THE CREDITORS COMMITTEE

The Creditors Committee joins with the petitioner, General Stores Corporation, in seeking reversal of the judgment of the Court of Appeals for the Second Circuit, dated April 14, 1955, which by a divided court affirmed the judgment of the United States District Court for the Southern District of New York, entered on March 7, 1955. The decision of the Court below prevents the petitioner and its unsecured creditors from utilizing the procedures of Chapter XI of the Bankruptcy Act on the ground that Chapter XI is not available to large corporations whose stock is publicly held.

Statement of the Case

On October 18, 1954, General Stores Corporation filed a petition in the District Court for the Southern District

of New York, in accordance with the provisions of Section 322* of Chapter XI of the Bankruptcy Act, in which it proposed an arrangement of its general unsecured obligations (R. 43a). Under the plan, such creditors would receive 100% of their claim, 20% upon confirmation of the plan and 20% annually thereafter. Statutory priority creditors would be paid in full (R. 14a).

Prior to the filing of the Chapter XI petition, General Stores Corporation conducted a chain of retail cigar stores (R. 42a). It owned the entire capital stock of Stineway Drug Company and Ford Hopkins Company, which subsidiary companies operate drug-restaurant chains in Chicago and midwestern states (R. 37a). However, all of the capital stock of these subsidiaries is pledged with the seller to secure the payment of notes representing the balance of the purchase price, approximately $2,000,000 (R. 43a, 46a). Under the agreement of purchase, these notes become immediately due and payable, with the consequent right of foreclosure on the collateral, in the event that a trustee is appointed for the purchaser or the purchaser files a petition for relief under any chapter of the Bankruptcy Act. The petitioner has obtained a waiver of this provision with respect to the present proceedings for an arrangement. *This waiver, however, does not extend to a Chapter X proceeding* (R. 46a).

The petitioner's capital structure consists of a little over 2,000,000 shares of $1.00 par common stock held by approximately 7,000 stockholders and listed on the American Stock Exchange (R. 30a). It has only one class of stockholders (R. 43a) and two classes of creditors, namely, priority creditors (in the main, for wages and taxes) and general unsecured creditors (in the main, merchandise and service creditors, former employees and landlords on rejected leases) (R. 40a, 42a).

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*11 U.S.C. 722, 52 Stat. 907

During the administration of these proceedings the petitioner rejected all of its existing executory lease agreements covering its retail cigar stores and converted into cash all of its merchandise inventory, fixtures and equipment, so that the assets of the petitioner now consist solely of (1) cash on hand and (2) petitioner's equity in all of the capital stock of the aforementioned subsidiaries (R. 54a), which obviously have value to the debtor only as going concerns.

In the course of these proceedings, it became apparent that the cash obtained by liquidation of the assets of the debtor was such as to require modification of the plan of arrangement as filed by the debtor. A proposal to pay the equivalent of 40% of unsecured creditors' claims in full satisfaction thereof was offered to the members of the Creditors Committee for its consideration, a majority of whom indicated that they would recommend acceptance of such amended plan if formally submitted.

No alteration, reorganization or change of the stock of the debtor or the interests or rights of stockholders is sought in these proceedings nor is any contemplated.

Summary of Argument

(1) The decision below prevents the debtor and its creditors from effecting a composition of the debtor's unsecured obligations pursuant to Chapter XI, despite the fact that a transfer of these proceedings to Chapter X, with the resultant delay, increased expenses and dissipation of assets, works to the disadvantage of all interests concerned. All this, notwithstanding the absence of the need for a reorganization of the debtor or the investigatory procedures of Chapter X.

(2) The decision below is the result of the misinterpretation of the decision of this Court in the *Realty** case and

* *Securities and Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434.

other decisions. The *Realty* case is inapplicable to the present case for the following reasons:

First, the factual situations presented in the *Realty* case and the instant case are dissimilar, particularly with reference to the debt structure of the respective debtors.

Second, the 1952 amendments of the Bankruptcy Act eliminated the "fair and equitable" standard, theretofore applicable to Chapter XI, which standard prompted the decision in the *Realty* case.

(5) Congress did not intend nor does the Bankruptcy Act by its terms preclude a large corporation with publicly owned stock from composing its unsecured debts, absent a reorganization of its capital structure. For that purpose, Chapter XI provides the only appropriate procedure and therefore the sole remedy.

THE ARGUMENT

The Court below erred in denying the debtor the right to proceed under Chapter XI solely because the debtor is a large corporation with publicly held stock.

The Court below declared that a debtor-corporation whose stock is listed on a stock exchange and publicly held may not compose its unsecured obligations unless it resorts to the elaborate investigatory, cumbersome and expensive procedures involved in a reorganization pursuant to Chapter X of the Bankruptcy Act. This despite the fact that neither the debtor, its creditors, nor its stockholders, seek a reorganization of the debtor.

The creditors view the compulsory transfer of these proceedings to Chapter X as extremely prejudicial to their rights, for such a transfer must result in unnecessary delay and dissipation of assets which would otherwise be available for application to the claims of creditors.

creditors should receive first consideration, the rights of stockholders being subordinate. The failure to recognize this cardinal principle magnifies the error committed below. No matter how lofty the motives of the Securities and Exchange Commission in suggesting that it alone possesses "adequate means for a disinterested analysis of the debtor's financial condition, the desirability of the continuance of the enterprise as presently constituted or on any other basis" (R. 36a), it is the creditors ultimately who must first be satisfied with the proposal of settlement whether it be by "arrangement" or "reorganization."

It is readily apparent that confirmation of a plan of arrangement pursuant to Chapter XI, which will relieve the debtor of its unsecured indebtedness, must work to the advantage of the petitioner's stockholders. Respondent, Max Shlensky, who owns only 3,000 shares, less than 2/10ths of one percent of the common stock of the petitioner, stands alone among the stockholders in his desire to compel a transfer of these proceedings to Chapter X, casting doubt as to the Circuit Court's statement that the stockholders are "concerned" and "wish some assurance of a fair plan now".* *No other stockholders have since joined with respondent, Shlensky, or sought to intervene in these proceedings.*

The Securities and Exchange Commission, however, argues that the continuance of the Chapter XI proceedings could adversely affect the stockholders because liquidation or reorganization might be merely postponed and in the meantime assets might be dissipated (Br. 42, 44). The record is completely devoid of any showing which even tends to justify this wholly unrealistic contention. There is every indication that a composition of the petitioner's unsecured obligations may be effected pursuant to Chapter XI with a minimum of expense and delay and resultant benefit to all interests concerned. Surely the delay and increased expenses of administration which are concomi-

* See Opinion of Clark, C.J., 222 F. 2d 234, 236.

taints of a Chapter X proceeding will increase the danger of liquidation many fold. It is for that very reason that its creditors are desirous to have these Chapter XI proceedings continue.

It is important to point out that under Section 366 of the Bankruptcy Act,* as amended in 1952, the fundamental requisite for the confirmation of a plan of arrangement pursuant to Chapter XI is that the plan be "for the best interests of the creditors." The creditors must be accorded primary consideration, and it is respectfully submitted that the interests of the creditors would be best served by a continuance of the proceeding in Chapter XI, rather than Chapter X. A transfer of these proceedings to Chapter X would require the appointment of a trustee who, to the extent directed by the Court, would be obliged to undertake an examination and investigation of the Petitioner's liabilities, property, management and numerous other matters relevant to the formulation of a plan. Such measures are totally unnecessary, for the Creditors Committee has conducted an extensive examination into the affairs of the petitioner and there has been no charge of fraud or impropriety. To compel a transfer to Chapter X, in order to incorporate the investigatory procedures of that chapter, will only result in delay and dissipation of the assets of the debtor-petitioner, without deriving the benefits those procedures were designed to afford.

On the other hand, reversal of the judgment below and a continuance of the Chapter XI proceeding will permit the petitioner and its general unsecured creditors to effect a settlement which would, in all probability, result in the creditors receiving 40% of their claim. As previously noted, this proposal received the approval of a majority of the Creditors Committee. Such a proposal is in the best interests of the stockholders of the petitioner, as well as its creditors, for confirmation of a plan of arrangement pursuant to Chapter XI will result in an increase in the

*11 U. S. C. 766, 66 Stat. 433.

value of the stock of the company and the preservation of the stockholders' $2,000,000 investment in its two subsidiaries, Stineway Drug Company and Ford Hopkins Company.

The decision below preventing the petitioner and its creditors from proceeding towards the confirmation of a plan of arrangement pursuant to Chapter XI, is unwarranted under the provisions of the Bankruptcy Act and the previous decisions of this and other courts and is the result of a misinterpretation of the holding of this Court in the *U. S. Realty* case.*

In the *U. S. Realty* case the debtor had assets of $7,076,515 and liabilities of $5,051,416, of which only $74,916 was current. This indebtedness included two series of publicly held debentures aggregating $2,339,000, which were secured by corporate stock, and a $3,000,000 note secured by a first mortgage held by the debtor. The debtor was also liable as a guarantor of mortgage certificates in the sum of $3,710,500 issued by its wholly-owned subsidiary and held by some 900 holders. It was this latter obligation which the debtor sought to modify by a plan pursuant to Chapter XI.

This Court, limiting its decision to the particular situation presented,† held that the question whether any "fair and equitable" arrangement could be effected without readjustment of the capital structure of the debtor could best be answered in a Chapter X proceeding.

In the first instance it is noted that the debt structure of the petitioner in the present case is dissimilar to that of the debtor in the *U. S. Realty* case. The petitioner debtor does not have any debentures, bonds, mortgages, notes or any like obligations in the hands of the general public. It has but one class of stockholders. Indeed, the entire

* *Securities & Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434

† *Id.*, at page 454

corporate structure of the debtor-petitioner is one of complete simplicity.

Secondly, the decision in the *U. S. Realty* case is based upon the law as it then existed that any plan of arrangement under Chapter XI had to meet the "fair and equitable" standard. At 310 U. S. 434, 452, the Court wrote:

> "'Fair and equitable,' taken from § 77B and made the condition of confirmation under both Chapter X and Chapter XI are 'words of art' having a well understood meaning in reorganizations in equitable receiverships and under § 77B which is incorporated in the structure of both Chapters X and XI. See Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 115 et seq., 60 S. Ct. 1, 7, 84 L. Ed. 110. The phrase signifies that the plan or arrangement must conform to the rule of Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931, which established the principle which we recently applied in the Los Angeles case, *that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts, and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible.*" (Emphasis ours.)

In 1952 Congress amended Section 366 of the Bankruptcy Act * and eliminated the requirement that a plan of arrangement must be "fair and equitable". The House of Representatives, in its report accompanying amendatory bill S2234 (House Report No. 2320, 82nd Cong., 2nd Sess., in substance being the same as Senate Report No. 1395), said (2 U. S. Cong. & Adm. News '52, 1981):

> "These sections (Secs. 366, 472 and 656a) presently require a finding that a proposed plan under chapters XI, XII, and XIII shall be 'fair and equitable'. In fact, however, the fair and equitable rule, as interpreted in Northern Pacific Railway Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913) and

* 11 U. S. C. 766; 66 Stat. 433.

Case v. Los Angeles Lumber Products Co. Ltd., 308 U. S. 106, 41 Am. B. R. (N. S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939), cannot realistically be applied in a chapter XI, XII, or XIII proceeding.

"Chapter XI has replaced the old composition procedure under former section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under chapter XI, XII, or XIII.

"The proposed amendment is designed to remove the fair and equitable provision, and by the paragraph added to each of the amended sections† it is made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters." (Interpolation ours.)

This renunciation by Congress of the rule laid down in the *Boyd* and *Los Angeles* cases, which prompted the majority decision in the *U. S. Realty* case, would appear to give greater credence to the minority decision. Judge Roberts in his dissent (concurred in by the then Chief Justice Hughes and Mr. Justice McReynolds) said (310 U. S. 434, 464):

"The Act will be searched in vain for any hint of such a distinction (the contention of S.E.C. that Chapter X applies to corporations whose securities are held by the public, while Chapter XI applies to close corporations). Small corporations are permitted to avail themselves of Chapter X if stockholders' or secured creditors' rights are to be affected; large corporations, under the very letter of Chapter XI, may avail themselves of its provisions *if all they desire to do is to extend or accommodate their unsecured indebtedness.* The smallest corporation cannot come in under Chapter XI if it desires what has been traditionally known as a reorganization. *The largest corporation may proceed under Chapter XI if it does not desire a reorganization.*" (Interpolation and emphasis ours.)

† The following paragraph was added to Section 366: "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement."

Nowhere in the record is there a single suggestion or the slightest intimation of the desire or necessity for adjusting the rights of stockholders nor why any reorganization of the debtor was desirable or necessary. This Court in the *U. S. Realty* case concluded that an arrangement was not possible nor could it be "fair and equitable and in the best interests of unsecured creditors without some readjustment of the rights of stockholders" (*Id.*, p. 453). If Congress saw fit to remove from the purview of a Chapter XI proceeding the necessity for requiring "an adjustment of the rights of stockholders", we submit it does not lie with the Court below to legislate interstitially by reincorporating the "fair and equitable" rule in a Chapter XI proceeding. This is all the more untenable where the creditors indicate a willingness to scale down their claims without any adjustment of the rights of stockholders. Where all that a corporate debtor seeks is a composition of its unsecured debts, Chapter X is unavailing and so held the Circuit Court of Appeals for the First Circuit in *John Hancock Mutual Life Ins. Co. v. Casey et al.*, 141 F. 2d 104, wherein the Court said (p. 107):

> "The defect is more fundamental here, however. *The plan is really not a Chapter X plan at all, because all it proposes is to effect a composition of extension of time, with reference to the unsecured debts*—in other words, an 'arrangement' within the purview of Chapter XI. Proceedings under Chapter X and Chapter XI are evidently mutually exclusive." (Emphasis ours.)

The *Mecca Temple* case* was also relied upon by the Court below as determinative of the issues involved in the present case. In that case the debtor, *a membership corporation*, was obligated in the sum of $1,200,000 principal and interest as a result of a public bond issue in the

* *Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock*, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784.

principal amount of $763,000. It proposed to pay each unsecured bondholder, 1,834 in number and located throughout the country, many of whom were non-members of the debtor, 10% of the principal amount of his outstanding bonds in installments of 1% per year for ten years, without interest. At 142 F. 2d 869, 871, the Court wrote:

> "Of course, there still is no well-defined answer in the borderline cases to the question as to whether a particular type corporation should be permitted to proceed under Chapter XI; but especially persuasive here is the nature of the debtor's financial structure, which is such that if a reorganization under Chapter X is not required, the interests of an objecting creditor like appellant are not likely to be adequately protected. We have seen that the annual income of the debtor is well in excess of $50,000; while disbursements total less than $15,000 (a sum which appellant urges could easily be substantially reduced); and yet there is no explanation of the use to which the balance of the receipts is being put. Some explanation is surely due the creditors before they should be obliged to accept 10 cents on the dollar for their principal and nothing at all for their long overdue interest. Should the plan of arrangement proposed in the petition be confirmed, the debtor would be able to liquidate its indebtedness for $7,630 per year for ten years—a result palpably unjust to the unsecured creditors of a corporation whose income appears to exceed its authorized expenditures by nearly $40,000 yearly. These facts by themselves suggest that the plan merits condemnation under Bankruptcy Act, § 366(2), which states that the court shall confirm an arrangement only if it is convinced that 'it is for the best interests of the creditors'."

In addition to finding the proposed plan "palpably unjust" the Court also followed the *U. S. Realty* case with respect to the "fair and equitable" rule and found a further reason to direct a transfer to Chapter X by applying the rule of the *Boyd* case. There has been nothing to indicate that the proposed arrangement in the present case is unjust or inequitable. The *Mecca Temple* case is, therefore, inapplicable on its facts to the present case and, in

any event, its value as a precedent is, along with the *U. S. Realty* case, seriously affected by the 1952 amendment to the Bankruptcy Act, which deleted the "fair and equitable" requirement.

In the *Transvision* case* a different panel of the Court below, in a substantially similar situation, affirmed an order of the District Court which denied an application by the Securities and Exchange Commission for a dismissal of the Chapter XI proceeding unless amended to a Chapter X proceeding. At 217 F. 2d 243, 247, Judge Medina, speaking for the Court, wrote:

> "The SEC has adduced no information which would tend to indicate that the plan is likely to fail, but has, at most, indicated that there may be some basis for suspecting possible improprieties in past management. Certainly, so ephemeral a suspicion is not an adequate basis upon which to overturn a plan which the District Court, on the facts before it at this time, appears to believe may ultimately be found feasible, and one which, necessarily, would have to be acceptable to at least a majority of the unsecured creditors before being approved."

In the present case there has not been even the slightest intimation of any wrongdoing which would require the investigative features of a Chapter X proceeding.† Moreover, as in the *Transvision* case, the proposed arrangement "may well enure to the ultimate advantage of the petitioner and its stockholders" (217 F. 2d 243, 247). Certainly to have dismissed this proceeding before the plan was found to be unfeasible would appear premature.

*In re Transvision, Inc., 217 F. 2d 243, certiorari denied 348 U. S. 952.

† Indeed, as stated by Judge Galston in his dissenting opinion below, 222 F. 2d 234, 238, redress for any wrong, if such were charged, may be had under the Laws of the State of New York, the domicile of the Debtor Petitioner.

Notwithstanding the economic advantages of permitting the present proceedings to remain in Chapter XI, the decision below directs a transfer to Chapter X. The Court below recognizes that the company's present corporate structure is not overly complicated.* Yet, despite the absence of a need for reorganization, the judgment below directs a transfer of the proceedings to Chapter X, apparently solely on the ground that the debtor is a corporation whose stock is publicly held, which was also the situation in the *Transvision* case.

The Creditors Committee earnestly urges that the Court below in denying the petitioner utilization of Chapter XI was in error. The holding of the Court below that a corporate debtor with publicly held stock may not resort to Chapter XI prevents the debtor from effecting a composition of its unsecured obligations within the Bankruptcy Act, greatly increases the danger of liquidation, and is therefore gravely prejudicial to the best interests of the creditors.

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* See opinion of Clark, C. J., 222 F. 2d 234, 235.

CONCLUSION

For the foregoing reasons, the judgment and order appealed from should be reversed.

Respectfully submitted.

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